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**Independent Auditors' Report on Compliance With
Federal Grant Requirements**

Independent Auditors' Report on Compliance With Federal Grant Requirements

The Governor and Legislature of
the State of California

We have audited the general purpose financial statements of the State of California as of and for the year ended June 30, 1996, and have issued our report thereon dated November 27, 1996. The California State University's compliance with federal requirements was audited by another independent auditor whose report has been furnished to us, and our opinion, insofar as it relates to the California State University, is based solely upon the report of the other independent auditor. The scope of our audit did not extend to financial aid programs administered by the University of California because it contracts with other independent certified public accountants for Office of Management and Budget (OMB) Circular A-133 audits. In addition, our audit of charges made by subrecipients of federal funds was limited to a review of the State's system for monitoring those subrecipients because subrecipients have OMB Circular A-128 audits or OMB Circular A-133 audits performed by other independent auditors.

The following sections provide our opinion on major federal programs, our report on general requirements for major federal programs, and our report on nonmajor federal programs.

Major Programs

We have also audited the State of California's compliance with the requirements governing types of services allowed or not allowed; eligibility; matching, level of effort, or earmarking of funds; reporting; special tests and provisions; federal financial reports and claims for advances and reimbursements; and amounts claimed or used for matching that are applicable to each of its major federal financial assistance programs. The major federal financial assistance programs for the year ended June 30, 1996, are identified in the schedule of federal assistance beginning on page 173. The State's management is responsible for the State's compliance with these requirements. Our responsibility is to express an opinion on compliance with these requirements based on our audit.

We conducted our audit of compliance with these requirements in accordance with generally accepted auditing standards; *Government Auditing Standards*, issued by the Comptroller of the United States; and OMB Circular A-128, *Audits of State and Local Governments*. Those standards and OMB Circular A-128 require that we plan and perform the audit to obtain reasonable assurance about whether material noncompliance with the requirements referred to above occurred. An audit includes examining, on a test basis, evidence about the State of California's compliance with those requirements. We believe that our audit provides a reasonable basis for our opinion.

In our opinion, the State of California complied, in all material respects, with the requirements governing types of services allowed or unallowed; eligibility; matching, level of effort, or earmarking of funds; reporting; special tests and provisions that are applicable; federal financial reports and claims for advances and reimbursements; and amounts claimed or used for matching that are applicable to each of its major federal financial assistance programs for the year ended June 30, 1996.

Further, we have applied procedures to test the State of California's compliance with the following general requirements applicable to each of its major federal financial assistance programs, which are identified in the schedule of federal financial assistance beginning on page 173, for the year ended June 30, 1996: political activity, Davis Bacon Act, civil rights, cash management, relocation assistance and real property acquisition, federal financial reports, allowable costs/cost principles, and administrative requirements. Our procedures for testing compliance with these requirements were limited to the applicable procedures described in the OMB's *Compliance Supplement for Single Audits of State and Local Governments*. Our procedures were substantially less in scope than an audit, the objective of which is the expression of an opinion on the State of California's compliance with requirements listed in this paragraph. Accordingly, we do not express such an opinion on the general requirements.

Nonmajor Programs

In connection with our audit of the State of California's general purpose financial statements and with our consideration of the State's control structure used to administer federal financial assistance programs, as required by OMB Circular A-128, we selected certain transactions applicable to certain nonmajor federal financial assistance programs for the year ended June 30, 1996. As required by OMB Circular A-128, we have performed auditing procedures to test compliance with the requirements governing types of services allowed, eligibility, and special tests and provisions that are applicable to those transactions. Our procedures were substantially less in scope than an audit, the objective of which is the expression of an opinion on the State's compliance with these requirements. Accordingly, we do not express such an opinion on the nonmajor programs.

With respect to all the items tested, the results of the procedures described above disclosed no material instances of noncompliance with the requirements identified in the preceding paragraphs. With respect to the items not tested, nothing came to our attention that caused us to believe that the State of California had not complied, in all material respects, with those requirements. However, the results of our audit procedures disclosed immaterial instances of noncompliance with those requirements. We discuss those instances of noncompliance and present recommendations to correct them in the section of our report beginning on page 53. The instances of noncompliance identified in the State's single audit report for fiscal year 1994-95 that have not been corrected are also included in those sections. Additionally, beginning on page 163, we present a schedule listing instances of noncompliance that we consider to be minor. We considered these instances of noncompliance in forming our opinion on compliance with requirements for major federal programs, which is expressed above.

This report is intended for the information of the governor and Legislature of the State of California and the management of the executive branch. However, this report is a matter of public record, and its distribution is not limited.

BUREAU OF STATE AUDITS

PHILIP J. JELICICH, CPA
Deputy State Auditor

May 16, 1997

Issues of General Concern Related to Federal Grant Requirements

Cash Management

The federal government enacted the Cash Management Improvement Act (CMIA) in 1990 to ensure greater efficiency, effectiveness, and equity in the exchange of funds between the federal government and the states. The CMIA requires the calculation of a liability to the federal government for interest charges when states request and receive federal funds in advance of disbursement to vendors, subrecipients, or program participants. Similarly, in instances in which the states incur costs for federal programs before receiving federal reimbursements, the CMIA allows the states to calculate interest charges against the federal government. To implement the CMIA, the federal government prescribed regulations for the transfer of funds for federal programs between the federal government and the states. The regulations differentiate between the requirements for most major federal programs, for which the State receives over \$20 million, and for other federal programs.

The CMIA requires the State to enter into an agreement with the federal government that covers applicable major federal programs and establishes the procedures and requirements for the transfer of funds. The procedures include calculating federal and state interest liabilities for each applicable program and annually reporting these interest liabilities to the federal government. However, since fiscal year 1994-95, the State and the federal government have been unable to agree on all of the procedures to implement the requirements of the CMIA. Therefore, in lieu of an agreement, in 1994 the federal government issued the CMIA Default Procedures (default procedures), which it amended in 1995, for the State to follow to implement the CMIA. The default procedures assigned the Department of Finance (DOF) the responsibility for implementing the procedures for tracking and calculating the state and federal interest liabilities for the major federal programs affected by the CMIA. In addition, the DOF is responsible for reporting the interest liability to the federal government in the CMIA Annual Report.

For federal programs that are not subject to an agreement or default procedures, the regulations require only that the State ensures the timing of a request for a cash advance and the amount requested come as close as administratively feasible to the actual cash disbursements.

We have identified the following issues related to the CMIA.

Excessive Federal Cash on Hand

Reference Number: 96-7-1-Various

Federal Catalog Number:

Federal Program Title: See listing of the specific federal program details following the discussion of the issues below.

Federal Award Number and Period:

State Administering Department:

Criteria

In our review of federal programs, we determined that the following were among the compliance requirements related to cash management:

The Code of Federal Regulations, Title 31, Section 205.20(a), requires that the timing and amount of cash advances be as close as administratively possible to the actual cash outlay.

The Code of Federal Regulations, Title 34, Section 74.22(b)(2) and Title 45, Section 74.22(b)(2), requires that cash advances be limited to the minimum amounts needed and be timed to be in accordance with actual, immediate cash requirements.

Condition

The State does not always ensure that departments limit the timing and amount of cash advances to the actual immediate cash requirements. Failure to ensure that the timing and amount of cash advances are as close as administratively feasible to the actual cash outlay may cause the State to incur an interest liability to the federal government. Specifically, we found that:

- The Department of Health Services (department) maintained excess cash balances for the HIV Care Formula Grants Program. The department's accounting section records cash advances and expenditures for the program by fiscal year and project work phase. For five of the eight work phases we reviewed that had activity during fiscal year 1995-96, the department maintained cash balances that did not meet its actual immediate needs. Specifically, for one work phase, the department maintained cash on hand from between \$26,700 and \$6.3 million for approximately nine months. For another work phase, the department held cash balances between \$54,400 and \$375,400 for ten months. For a third work phase, the department maintained balances between \$39,000 and \$104,100 for 52 days. For the remaining two work phases, the department had cash balances of approximately \$1,300 and \$3,200, respectively, for 1 to 1 1/2 years. We reported a similar issue during our audit for fiscal year 1994-95.
- In paying for support expenditures for the Special Education—Grants for Infants and Families With Disabilities Program, the Department of Developmental Services (department) did not match its receipt of funds with its disbursement of those funds. As a result, the department maintained cash balances for approximately six months that exceeded its immediate needs. The cash balances ranged from approximately \$200 to \$93,300. We reported a similar finding during our audit for fiscal year 1994-95.
- For one of seven cash requests we reviewed that were used to pay for local assistance expenditures for the Vocational Education—Basic Grants to States Program, the Department of Education (department) did not minimize the time between the receipt and disbursement of those funds. As a result, the department maintained a cash balance of \$653,800 for at least 38 days.

Recommendation

To ensure that the State complies with federal requirements, the State should ensure that departments limit the cash advances to the minimum amounts needed and time the advances according to their actual, immediate cash requirements.

View of Departments

According to a Department of Health Services accounting administrator, prior to November 1995, the employee responsible for cash requests for the HIV Care Formula Grants Program maintained cash balances for several different work phases. After the employee was replaced, the department decided in March 1996 that it should request cash only for actual expenditures. The accounting administrator also stated that the \$6.3 million cash balance for one work phase resulted from clerical errors that occurred in December 1995 and January 1996. The department discovered the errors in March 1996 and used the excess balance for expenditures in May 1996. For the other work phases, the department either reduced the cash balances by actual expenditures by March 1996 or moved the cash balances to the current work phase in January 1997.

The Department of Developmental Services accounting section chief stated that the \$93,000 excess cash balance occurred because expenditure information was incorrectly keyed into the State's accounting system. As a result, a claim schedule was not generated and forwarded for payment after the department requested the federal funds. The accounting section chief stated that the department has since changed its procedures to request federal funds only when a claim schedule is generated. Smaller excess cash balances occurred because the department estimated the amounts of its requests for federal funds to cover Interagency Coordinating Council member travel expenses. Therefore, when the travel expenses were less than the estimates, the department held excess cash. According to the accounting section chief, beginning in fiscal year 1996-97, the department will process these travel claims for payment through the department's clearing account before the federal funds are requested.

The California Department of Education (CDE) concurs with this finding. The CDE's Federal Funds Unit processed approximately 125 requests for federal funds during fiscal year 1995-96. The CDE inadvertently maintained a cash balance for the one federal cash request identified.

As a result of the delay in disbursement of the federal funds, the State accrued interest on the funds and the CDE properly reported the cash balance on its quarterly Cash Management report submitted to the Department of Finance (DOF). Following Cash Management Improvement Act (CMIA) procedures, the DOF subtracted the interest earned on the federal funds from the amount due from the federal government for all State programs. CMIA procedures work to equalize the benefit of holding cash balances according to the use and source of the funds in question.

The CDE has implemented a more stringent review and documentation process to minimize the time between the receipt and disbursement of federal funds. The Federal Funds Unit manager will review monthly reports to immediately identify cash balances of federal funds. All delays in disbursement of federal funds will be documented, clearly describing the reasons for the delays.

Department of Education

Federal Catalog Number: 84.048

Federal Program Title: Vocational Education—Basic Grants to States

Federal Award Number and Period: V048A50005; FFY 1995-96

State Administering Department: Department of Education

Federal Catalog Number: 84.181

Federal Program Title: Special Education—Grants for Infants and Families With Disabilities

Federal Award Number and Period: H181A50071; FFY 1994-95

State Administering Department: Department of Developmental Services

Department of Health and Human Services

Federal Catalog Number: 93.917

Federal Program Title: HIV Care Formula Grant

Federal Award Number and Period: BRX/070041-93; FFY 1993-94
BRX/070041-94-0; FFY 1994-95
BRX/070041-95-0; FFY 1995-96

State Administering Department: Department of Health Services

Noncompliance With Federal Regulations or Default Procedures

Department of the Treasury

Reference Number: 96-7-2-Various

Federal Catalog Number: Refer to Table 1

Federal Program Title: Refer to Table 1

Federal Award Number and Period: Various

State Administering Department: Department of Finance (DOF)

Criteria

The Code of Federal Regulations, Title 31, Section 205.14(b)(1), does not allow the State to be reimbursed for the direct costs of implementing the Cash Management Improvement Act (CMIA) when the State is using default procedures.

The Code of Federal Regulations, Title 31, Section 205.15(a)(2), requires that the annual report submitted by the State include the state interest liability for each program subject to the regulations. The CMIA Default Procedures, Section 7.2.1 and 7.6.1, established requirements for calculating federal and state interest liabilities, respectively. Further, CMIA Default Procedures, Section 7.2.2(c) and Section 7.6.2(c), provide the methods for calculating these liabilities.

These default procedures require that the time period between when the State issues warrants to recipients and when the warrants are cleared by the bank be determined by the clearance patterns specified in the default procedures. Exhibit A of the default procedures lists by program the average days to clearance that are to be used for calculating state and federal interest liabilities.

Condition

The State could not or did not always comply with federal regulations or the default procedures required by the federal government when implementing CMIA for fiscal year 1995-96. As a result, the interest liability the State calculated and reported to the federal government for the fiscal year did not always comply with the regulations or default procedures. The State reported a net state interest liability of \$11.6 million related to the fiscal year 1995-96 CMIA. The net effect of the State's noncompliance is an overstatement totaling approximately \$148,200 in interest liabilities for applicable programs.

As shown in Table 1, we identified the following instances in which the State's noncompliance with the federal regulations or default procedures had an effect on the interest liability calculated and reported to the federal government.

- The Department of Finance (DOF) understated the State's interest liability due to the federal government because it did not include in the Annual Report approximately \$432,100 of state interest liability it calculated for federal funds advanced to the State for payroll expenditures. The DOF required departments to track and report the advance payroll expenditure information, and the DOF calculated the resulting state interest liability as required by the default procedures. However, the DOF did not include this information in the Annual Report because it believes it would not be equitable to include such information since the State cannot efficiently and effectively calculate the federal interest liability to the State when the State uses its own funds to cover payroll and operating costs for applicable federal programs. Specifically, the payroll and operating expenditures initially paid by the State and later reimbursed by the federal government are not tracked by the departments and therefore, not included in the interest liability calculation. If the State could track and calculate the interest liability resulting from these payroll and operating expenditures, the federal government would owe the State for interest liabilities.

- The DOF overstated the State's interest liability to the federal government for local assistance expenditures by approximately \$787,400, and it understated the interest liability for payroll expenditures by \$11,700 because the State used clearance patterns in the calculations that did not comply with the default procedures. The clearance patterns represent the average number of days from warrant issuance to redemption. For local assistance expenditures, the State used clearance patterns that were generally more days than those specified in the default procedures. In contrast, for payroll expenditures the State used a clearance pattern that was fewer days than the pattern specified in the default procedures.
- The DOF understated the State's interest liability due to the federal government by \$15,900 for other errors that we identified. For the Disaster Assistance program, the DOF did not use the correct amount of transferred funds in its calculation. In addition, for 2 of the 21 programs we audited, we found errors in the information departments reported to the DOF. Specifically, we found that one department omitted a transfer of funds for the Disaster Assistance program, and another department did not correctly report for the Community Development Block Grant—States Program the number of days the federal funds were in the state treasury before a warrant was issued.

In addition, the State understated its interest liability by \$179,500 because it offset the liability by the direct cost of implementing CMIA even though the offset is not allowed when the State is using default procedures.

Recommendation

The State should correct errors that affect the interest liability reported in the Annual Report. In addition, the State should continue to discuss with the federal government the areas of disagreement in the transfer of funds between the State and the federal government.

View of the Department

The supervising administrative analyst of the DOF's Fiscal Systems and Consulting Unit stated during fiscal year 1995-96, the DOF continued to negotiate with the federal government about various outstanding issues. The negotiations resolved some minor issues; major issues, such as state administrative costs, funding techniques for specific programs, and allowable direct costs, remain unresolved. In addition, the supervising administrative analyst stated the amended default procedures contained some errors and omissions.

The DOF identified the following specific issues:

- The payment of state interest liability for payroll funds requested in advance and federal interest liability for payroll and operating expenses requested in arrears is one of the outstanding issues still being negotiated with the federal government. Based on a DOF study that was reviewed and reported on in April 1995 by the Bureau of State Audits (BSA), the federal interest liability would exceed the state interest liability by a small amount. Thus, in DOF's opinion, the administrative difficulties for state agencies to track the cash flow and calculate the federal interest liability cannot be solved effectively. In April 1996, the U.S. General Accounting Office (GAO) reviewed the BSA report. Although the DOF has received no information on the results of the GAO's review, the DOF believes

the GAO will confirm the BSA's findings. If the U.S. Treasury accepts the BSA's findings and agrees to no exchange of interest for the state administrative costs, the State will not owe the federal government any interest for advance funding of payroll expenditures.

- The DOF believes two programs should be excluded from the incorrect clearance patterns calculation in Table 1. The federal government added the programs to the default procedures in fiscal year 1995-96 but, according to the DOF, did not amend the default procedures (Exhibit A) to include clearance patterns for these programs. In addition, the DOF contends that it neither overstated nor understated the interest liability related to the use of different clearance patterns because the clearance patterns it used reflect more accurately the actual warrant redemption activities. The DOF revises the clearance patterns each year based on warrant redemption activities of the prior calendar year. As required by the Code of Federal Regulations, Title 31, Section 205.8(c), the DOF notified the federal government in June 1995 of the changes to the patterns. However, when the federal government amended the default procedures for fiscal year 1995-96, it omitted the most current clearance patterns the DOF provided. Thus, the DOF believes that, if the federal government had included the revised clearance patterns when it amended the default procedures, the findings would not have been made.
- The \$15,900 understated interest liability that resulted from two departmental reporting errors and one DOF calculating error represent a 0.1 percent error rate of the \$11.6 million net state interest liability reported in the 1995-96 Annual Report. The DOF will continue its ongoing effort to reduce reporting errors by analyzing the information reported by state agencies, providing ongoing consultation and training, and annually reminding state agencies of their responsibilities.
- The DOF argues that the State is entitled to direct cost reimbursement even if the State does not have a signed agreement. The state agencies and the DOF incur costs to track federal funds and to calculate the interest liability. Therefore, all costs associated with CMIA activities should be eligible for reimbursement as an offset against the State's interest liability.

Table 1

**Interest Liability Effect of Noncompliance with
Cash Management Regulations and Procedures**

Federal Catalog Number	Program Name	Overstated (Understated)			
		Omission of Advance Payroll Liability	Incorrect Clearance Patterns		
			Advance Payroll	Local Assistance	Other
10.553	School Breakfast Program			\$ 5,593.42	
10.555	National School Lunch Program			152,991.26	
10.557	Special Supplemental Food Program for Women, Infants, and Children			3,913.51	
10.558	Child and Adult Care Food Program			(40,046.79)	
10.561	State Administrative Matching Grants for Food Stamp Program	\$ (3,639.95)	\$ (85.17)	(3,110.26)	
14.228	Community Development Block Grants—State's Program	(103.43)	(1.29)	9,059.47	\$ (6.80)
16.579	Drug Control and System Improvement—Formula Grant			5,156.34	
17.207	Employment Service	(46,086.03)	(1,269.22)		
17.225	Unemployment Insurance	(263,488.41)	(7,030.25)		
17.245	Trade Adjustment Assistance—Workers	(1,215.87)	(33.55)		
17.246	Employment and Training Assistance—Dislocated Workers	(11,893.64)	(284.61)		
17.250	Job Training Partnership Act	(7,430.42)	(174.51)		
20.600	State and Community Highway Safety			2,595.11	
83.516	Disaster Assistance			115,345.94	\$(15,910.79)
84.002	Adult Education—State Administered Basic Grant Program			78.78	
84.010	Title 1 Grants to Local Educational Agencies			(117,511.81)	
84.011	Migrant Education—Basic State Grant Program			16,132.37	
84.027	Special Education—Grants to States			(56,403.58)	
84.048	Vocational Education—Basic Grants to States			124,596.43	
84.126	Rehabilitation Services—Vocational Rehabilitation Grants to States	(8,046.52)	(691.78)	(2,217.87)	
84.151	Chapter 2—State Block Grants			275.69	
84.164	Eisenhower Mathematics and Science Education—State Grants			576.87	
84.173	Special Education—Preschool Grants			150.60	
84.186	Safe and Drug-Free Schools—State Grants			8,647.80	
93.044	Special Programs for the Aging—Title III, Part B—Grants for Supportive Services and Senior Centers			(5,970.16)	
93.045	Special Programs for the Aging—Title III, Part C—Nutrition Services			(8,776.43)	

Federal Catalog Number	Program Name	Overstated (Understated)			
		Omission of Advance Payroll Liability	Incorrect Clearance Patterns		
			Advance Payroll	Local Assistance	Other
93.560	Family Support Payments to States—Assistance Payments	(6,532.76)	(147.77)	111,484.47	
93.561	Job Opportunity and Basic Skills Training	(325.92)	(7.54)	(53,599.83)	
93.563	Child Support Enforcement	(3,531.25)	(90.18)	4,579.89	
93.566	Refugee and Entrant Assistance—State Administered Programs	(423.36)	(9.88)	4,468.77	
93.568	Low-Income Home Energy Assistance	\$ (4,577.89)	\$ (108.99)	\$ (4,509.96)	
93.569	Community Services Block Grant	\$ (1,590.63)	\$ (37.18)	\$ 4,938.24	
93.574	Child Care for Families At-Risk of Welfare Dependency			(5,110.16)	
93.575	Child Care and Development Block Grant			41,722.85	
93.645	Child Welfare Services—State Grants	(246.76)	(5.73)	7,804.67	
93.658	Foster Care—Title IV-E	(5,708.89)	(135.41)	9,349.04	
93.659	Adoption Assistance	(780.01)	(18.25)	5,787.72	
93.778	Medical Assistance Program			445,515.00	
93.958	Block Grants for Community Mental Health Services			(5,782.93)	
93.959	Block Grants for Prevention and Treatment of Substance Abuse	(5,714.89)	(156.69)	9,668.83	
96.001	Social Security—Disability Insurance	(60,730.26)	(1,386.87)		
Total		\$(432,066.89)	\$(11,674.87)	\$787,393.29	\$(15,917.59)

Miscellaneous Federal Cash Management Issues

Department of the Treasury

Reference Number: 96-7-3-Various

Federal Catalog Number: See listing of the specific federal program details following the discussion of the issues below.

Federal Program Title:

Federal Award Number and Period:

State Administering Department: Department of Finance (DOF)

Criteria

The Cash Management Improvement Act (CMIA) Default Procedures, Section 5.2.2, describe the “pre-issuance funding techniques.” When state agencies use this technique, they must make every effort to request funds so that the funds are deposited in a state account not more than two business days before disbursement.

The CMIA Default Procedures, sections 5.3.17, 5.3.18, 5.3.20, 5.3.22, 5.3.23, and 5.3.25, require that the “in advance of issuance” funding technique be used for payroll expenditures of the Migrant Education—Basic State Grant Program, Special Education—Grants to States Program, Vocational Education—Basic Grants to States Program, Chapter 2—State Block Grants Program, Eisenhower Mathematics and Science Education—State Grants Program, and the Safe and Drug-Free Schools—States Grants Program.

The CMIA Default Procedures, Section 5.3.44, require funds to be drawn weekly for Maternal and Child Health Services Block Grant Program expenditures and require that the requests be based on weekly estimates of expenditures.

Condition

The State did not always comply with default procedures. In addition, one department did not comply with the required time limits for the pre-issuance funding technique. Specifically, we identified the following instances of noncompliance with the default procedures:

- According to the Department of Finance (DOF), the Department of Health Services was unable to make the required weekly estimate of federal expenditures and the required request for the funds from the federal government in advance of the expenditures for the Maternal and Child Health Services Block Grant because it was unable to obtain timely information from the State’s accounting system to accommodate the requirements of the default procedures. Therefore, the State advanced its own funds to pay federal program expenditures for this program, and the federal government reimbursed the State. However, the State could not calculate an interest liability for the program even though it would have been fair for it to do so since it advanced its own funds. We reported a similar issue during our audit for fiscal year 1994-95.

- The Department of Education used funding techniques different from the techniques required by the default procedures for payroll expenditures in six federal programs. The DOF proposed for fiscal year 1995-96 to use the same funding technique for these programs administered by the Department of Education that it uses for other programs. However, the federal government did not make the proposed revisions when it amended the default procedures. As a result, the Department of Education used an after-cost allocation rather than the required advance funding for the Migrant Education—Basic State Grant Program, Special Education—Grants to States Program, Vocational Education—Basic Grants to States Program, Chapter 2—State Block Grants Program, Eisenhower Mathematics and Science Education—State Grants Program, and the Safe and Drug-Free Schools—States Grants Program.
- Using the required pre-issuance funding technique, the Office of Criminal Justice Planning (office) disbursed within two business days only 8 of 188 requests for federal funds (4.3 percent) for the Drug Control and System Improvement—Formula Grant Program. The office disbursed \$36.5 million during fiscal year 1995-96. These disbursements were made, on average, seven business days from the request.

Recommendation

The State should continue to discuss with the federal government the instances in which it cannot comply with the default procedures because the State's systems do not accommodate the requirements of the default procedures. In addition, the State should propose again to amend the default procedures for certain programs the Department of Education uses to reflect the same funding technique it uses for other programs. Finally, the State should ensure the Office of Criminal Justice Planning makes every effort to disburse its federal funds within two business days of the advance.

View of the Department

The supervising administrative analyst of the DOF's Fiscal Systems and Consulting Unit provided the DOF's perspectives on the findings:

- The funding technique for the Maternal and Child Health Services Block Grant Program is one of the outstanding issues still being negotiated with the federal government. The primary area of disagreement is the State's use of a reimbursement funding technique. The DOF argues that the CMIA does not prohibit the use of a reimbursement funding technique. It indicates that, if a State disburses its own funds for federal program purposes, the State is entitled to interest from the federal government. However, the CMIA regulations contain a specific prohibition against the use of a reimbursement funding technique. The DOF believes that this prohibition is not equitable to the states. In addition, the State should have the option to not calculate the federal interest liability due to lack of available information and the cost of calculating the liability.
- The State's proposed agreement with the federal government for fiscal year 1995-96 revised the funding technique for the payroll component of the six federal programs administered by the Department of Education. However, the federal government did not amend the default procedures for these funding technique changes. The DOF believes that the after-cost allocation is the correct technique for the six programs. Between 1994-

95 and 1995-96, the Department of Education's method for requesting federal funds for payroll did not change. The revision to the proposed agreement was to correct the funding technique description.

- The DOF is aware that the Office of Criminal Justice Planning (office) did not meet the time limit for the pre-issuance funding technique for a significant number of disbursements for the Drug Control and System Improvement—Formula Grant program. The default procedures allow a state agency to exceed the two-day requirement for a small number of disbursements because of variances in processing time. However, the office exceeded the time limit for the majority of its disbursements. The DOF will continue to work with the office to improve its fund request and claim schedule processes to reduce the number of days from the deposit to the disbursement of federal funds.

Department of Justice

Federal Catalog Number:	16.579
Federal Program Title:	Drug Control and System Improvement—Formula Grant
Federal Award Number and Period:	94DBCX0006; FFY 1993-94 95DBCX0006; FFY 1994-95

Department of Education

Federal Catalog Number:	84.011
Federal Program Title:	Migrant Education—Basic State Grant Program
Federal Award Number and Period:	S011A50005-95A; FFY 1995-96
Federal Catalog Number:	84.027
Federal Program Title:	Special Education—Grants to States
Federal Award Number and Period:	H027A50115-96; FFY 1995-96
Federal Catalog Number:	84.048
Federal Program Title:	Vocational Education—Basic Grants to States
Federal Award Number and Period:	V048A50005; FFY 1995-96

Federal Catalog Number: 84.151
Federal Program Title: Chapter 2—State Block Grants
Federal Award Number and Period: S151Z40057; FFY 1994-95

Federal Catalog Number: 84.164
Federal Program Title: Eisenhower Mathematics and Science
Education—State Grants
Federal Award Number and Period: S164A40005; FFY 1994-95

Federal Catalog Number: 84.186
Federal Program Title: Safe and Drug-Free Schools—States Grants
Federal Award Number and Period: S186A50005; FFY 1995-96

Department of Health and Human Services

Federal Catalog Number: 93.994
Federal Program Title: Maternal and Child Health Services Block Grant
to the States
Federal Award Number and Period: 95B1CAMCHS-04; FFY 1994-95

Cost Allocation

Recipients of grant moneys, including state departments, must ensure that the costs they incur for federal grants meet grant objectives. The federal Office of Management and Budget, Circular A-87 Revised, guides grant recipients on the types of costs they can charge to federal grants and on the acceptable methods for demonstrating the propriety of those costs. Circular A-87 provides specific guidance on the cost of providing services funded by grants, and guidance on allocating costs that indirectly benefit grant recipients. In the following two sections, we discuss instances of noncompliance with Circular A-87 found during our audit.

Noncompliance With Requirements To Certify or Document Personal Service Costs

Department of Agriculture

Department of Education

Department of Health and Human Services

Reference Number: 96-8-1-Variou

Federal Catalog Number: See listing of the specific federal program details following the discussion of the issues below.

Federal Program Title:

Federal Award Number and Period:

State Administering Department: Various

Criteria

In our review of federal programs, we determined that the following were among the compliance requirements related to cost allocation:

The federal Office of Management and Budget (OMB), Circular A-87 Revised, Section 839A, 11.h(4), requires salaries and wages charged to a federal grant for employees working on multiple cost objectives or programs to be supported by personnel activity reports. Additionally, Section 839A, 11.h(5), states personnel activity reports must reflect an after-the-fact distribution of the actual activity of each employee, must account for the total activity of each employee, and must be signed by the employee. Section 839A, h.(5), states when employees are expected to work solely on one federal grant or cost objective, charges for salaries will be supported by periodic certifications that the employees worked solely on that program for the period covered by the certifications. The certifications will be prepared at least semiannually

and will be signed by the employee or supervisor. Finally, Section 839A, 11.h.5(e), states that budget estimates or other distribution percentages determined before the services are performed do not qualify as support for charges to the federal grant.

Condition

Many departments do not fully comply with new federal requirements to certify or document personal service costs such as salaries and benefits charged to the federal grant programs they administer. In our reviews of the cost allocation systems at 18 departments, we found instances in which the departments failed to keep personnel activity reports certifying the amount of time spent on each program when employees worked on more than one program.

For employees who work exclusively on one program, several departments also failed to have these employees certify semiannually how they spent their time, as required. These requirements became effective for all grants awarded after September 1, 1995. When such records do not exist, there is an increased likelihood of under- or over-charges to federal grants, and the related over- and under-reimbursement to the State can be significant. We have the following specific concerns:

- Twelve of the 18 departments had employees who worked on a single program or award and were charging the related personal service costs to grants awarded after September 1, 1995. Therefore, the departments should have prepared periodic certifications for these employees to support the personal service costs charged to federal grants. However, three departments, the Department of Aging, the Department of Health Services (DHS), and the Department of Rehabilitation, did not prepare the certifications.
- Eight of the 18 departments had employees charging multiple grants awarded after September 1, 1995. One of the eight departments failed to require or use personnel activity reports, such as certified time sheets, for employees who worked on certain grants. Specifically, the California Community Colleges, Chancellor's Office (Chancellor's Office) allocated personal service costs based on budget estimates rather than actual time worked. We reviewed time sheets for five employees who worked on the Vocational Education program. Although these employees prepared time sheets, the Chancellor's Office allocated the related personal service costs based on preliminary budget estimates. As a result, personal service costs for four of the five employees were incorrectly allocated to various state and federal programs, including the Vocational Education—Basic Grants to States program. The amounts inappropriately allocated ranged from 1.1 percent to 15 percent of the employees' monthly salaries. This resulted in a \$2,000 under-allocation of personal service costs to the vocational education program for the one month we reviewed.

In a similar instance of noncompliance, the DHS used Childhood Immigration Grants funds to pay \$87,000 in salaries for two Local Assistance Branch employees from February 1, 1996, through December 31, 1996, without supporting personnel activity reports. The immunization Branch agreed to budget two Local Assistance Branch employees using federal funds to assist in a study of prenatal screening practices in California hospitals. However, according to the assistant chief of the Division of Communicable Disease Control, the two employees did not perform the study alone; rather, a total of 14 employees completed the study. The assistant chief said that if only the two employees who were funded had performed the study, the department would have incurred higher costs for

travel-related expenses throughout the State. Although the DHS charged salaries to the grant for the two employees, neither the Immunization Branch nor the Local Assistance Branch could provide monthly activity reports to indicate the amount of time the employees worked on the survey.

The Immunization Branch also used Childhood Immunization Grants funds to pay \$211,000 in salaries for three employees of the Data Systems Branch from July 1, 1995, through December 31, 1996, even though the employees did not work on activities related to the grant program. The Immunization Branch agreed to have the Data Systems Branch design a data processing system to track statewide immunization information with costs reimbursed from federal grant funds. The Immunization Branch then included in its budget the costs for three new Data Systems Branch employees who were to develop the statewide immunization information system. According to the assistant chief of the Immunization Branch, the branch agreed to have the work performed by other, more experienced, senior Data Systems Branch staff as opposed to the less experienced staff funded by the federal grant program. However, this method did not allocate cost accurately to the federal grant program.

Recommendation

Each grant recipient should establish an adequate time reporting system that uses activity reports or certifications to document and account for the total activity of each employee.

Views of Departments

California Community Colleges, Chancellor's Office:

During fiscal year 1996-97, staff that were funded wholly or in part with federal dollars were required to submit a monthly employee time report. This report shows actual hours worked in specific funding categories.

These time sheets have recently been analyzed and adjustments are being made which include reducing or increasing funding sources for certain individuals to more accurately reflect their actual work and to keep within funding limits. In fiscal year 1997-98, the Chancellor's Office plans to review and analyze these time reports on a quarterly basis and make adjustments, if needed.

Department of Aging:

The department concurs with our finding. Semiannual certification of time spent by employees working on a single federal award has been instituted.

Department of Health Services:

The department agrees with the audit finding that staff working on a single federal award or cost objective did not complete semiannual certifications. Beginning in 1997, staff working 100 percent of their time on a single project will complete certification for the period ending June 30 and December 31 of each year. When staff work on multiple activities, the department will

work with the federal agency to review the current time reporting system. The department will implement changes as needed.

Department of Rehabilitation:

The department agrees with the issue as described. However, it disagrees with the recommendation. It argues that over 99 percent of the department's employees work on a single federal grant, and 98 percent of those employees work on the same grant. The department has not established a cost accounting system to allocate employee time among various cost objectives because essentially all employees are funded from only one federal grant. Therefore, it seems burdensome to require this staff to complete certifications. In these days of federal and state directives to streamline processes and reduce paperwork, the department questions whether the intent of the Circular A-87 is served by the creation of a certification system within this department.

Specific Federal Program Details

Department of Agriculture

Federal Catalog Number:	10.557
Federal Program Title:	Special Supplemental Food Program for Women, Infants, and Children
Federal Award Number and Period:	7F6003; October 1, 1995 through September 30, 1996
State Administering Department:	Department of Health Services

Department of Education

Federal Catalog Number:	84.048
Federal Program Title:	Vocational Education—Basic Grants to States
Federal Award Number and Period:	V048A40005; July 7, 1994 through September 30, 1995
State Administering Department:	California Community Colleges, Chancellor's Office
Federal Catalog Number:	84.126
Federal Program Title:	Rehabilitation Services—Vocational Rehabilitation Grants to States
Federal Award Number and Period:	H126A60005; October 1, 1995 through September 30, 1997
State Administering Department:	Department of Rehabilitation

Department of Health and Human Services

Federal Catalog Number:	93.044
Federal Program Title:	Special Programs for the Aging—Title III, Part B— Grants for Supportive Services and Senior Citizens
Federal Award Number and Period:	Various
State Administering Department:	Department of Aging
Federal Catalog Number:	93.045
Federal Program Title:	Special Programs for the Aging—Title III, Part C—Nutrition Services
Federal Award Number and Period:	Various
State Administering Department:	Department of Aging
Federal Catalog Number:	93.268
Federal Program Title:	Childhood Immunization Grants
Federal Award Number and Period:	H23/CCH904423-07; January 1, 1996 through December 31, 1996
State Administering Department:	Department of Health Services
Federal Catalog Number:	93.566
Federal Program Title:	Refugee and Entrance Assistance—State Administered Programs
Federal Award Number and Period:	G-96-AA-CA-9115; October 1, 1995 through September 30, 1996
State Administering Department:	Department of Health Services
Federal Catalog Number:	93.778
Federal Program Title:	Medical Assistance Program
Federal Award Number and Period:	MAP 05-9605CA5-28; October 1, 1995 through June 30, 1996 ADM 05-9605CA5048; October 1, 1995 through June 30, 1996

State Administering Department:	Department of Health Services
Federal Catalog Number:	93.777
Federal Program Title:	State Survey and Certification of Health Care Providers and Supplies
Federal Award Number and Period:	05-9605CA5000; October 1, 1995 through September 30, 1996 05-9605CA5001; October 1, 1995 through September 30, 1996
State Administering Department:	Department of Health Services
Federal Catalog Number:	93.917
Federal Program Title:	HIV Care Formula Grants
Federal Award Number and Period:	BRX-0/0041-96-3; April 1, 1996 through March 31, 1997
State Administering Department:	Department of Health Services

Continuing Cost Allocation Problems at Two Departments

Department of Health and Human Services

Department of Justice

Reference Number:	96-8-2-Various
Federal Catalog Number:	See listing of the specific federal program details following the discussion of the issues below.
Federal Program Title:	
Federal Award Number and Period:	
State Administering Departments:	Department of Community Services and Development Office of Criminal Justice Planning

Criteria

In our review of federal programs, we determined that the following were among the compliance requirements related to costs allocation:

The Office of Management and Budget, Circular A-87, establishes the principles and standards for determining costs under federal awards. The guidelines of the Circular A-87 require that costs charged to federal programs must be necessary and reasonable for the proper and efficient performance and administration of the federal award. In addition, when employees work on multiple activities, a distribution of their salaries must be supported by monthly personnel activity reports that reflect an after-the-fact distribution of the actual activity of each employee. Further, Circular A-87 distinguishes between direct and indirect costs charged to federal grants. Section 836 E.2.a of the circular states that direct costs chargeable to federal grants include compensation of employees for the time devoted specifically to meeting the objectives of those grants. Section 834 C.3.a states a cost may be allocated to a particular cost objective or program if the goods or services involved are chargeable and assignable to such cost objectives in accordance with the relative benefits received.

Condition

The following two departments have continuing problems with the allocation of costs to federal grant programs: the Department of Community Services and Development and the Office of Criminal Justice Planning.

Department of Community Services and Development

The Department of Community Services and Development (department) continues administrative practices that result in improper charges of its operating costs to the programs it administers. The department operates the Community Services Block Grant program (CSBG), the Low-Income Home Energy Assistance Program (LIHEAP), and other federal and nonfederal programs designed to provide assistance to low-income Californians. However, we found that the department does not ensure that the costs of its employees' salaries are correctly charged to the programs it operates based on the actual time the employees worked on the programs. As a result, the department does not charge each program a fair share of its labor costs and other costs that are allocated based on the amount of labor costs directly charged to each program. Because the department does not ensure that it correctly charges its administrative costs, it cannot be certain it spends federal funds on the programs the funds were awarded to support or that the department complies with the spending restrictions of the federal programs it operates.

We reviewed employees' time sheets for fiscal year 1995-96 and found that, although time sheets are reviewed by program managers, the department does not ensure that employees correctly charge their time to the programs they work on each month. For example, in July 1995, we found that four employees ultimately charged all of their time (514 hours) to the Home Energy Assistance Program (HEAP) component of the LIHEAP when the original entries to their time sheets showed they had also worked on three other programs. Two additional employees charged all of their time (233 hours) to the LIHEAP with comments on their time sheets that management had directed them to charge their time to the LIHEAP program. In

total, five of the above time sheets carried comments that the employees were directed to charge their time to the LIHEAP. For August and September 1995, we found that five employees charged time, totaling 597 hours, to the LIHEAP when their time sheets described they had worked on the CSBG program. On a sample basis, we examined documents from the department's contract files that demonstrated the employees had worked on CSBG activities. We identified six additional employees who charged all of their time in August and September 1995 (731 hours) to the LIHEAP when their time sheets described that they had worked on more than one program during those months.

In an attempt to correct the improper time charges, the chief of fiscal operations summarized the hours for the employees who had charged time to the HEAP component of the LIHEAP during July, August, and September 1995 and reassigned the cost for their time to an account used to accumulate program administrative costs. Program administrative costs are those costs that the department cannot directly identify to a specific program. The department then used percentages to allocate the costs to programs that historically would have benefited from program administrative activities. As a result, the department allocated personal services costs, totaling approximately \$110,960, to federal and nonfederal programs in proportions that did not represent their fair share when the costs should have been directly charged to the federal program that benefited from the services of the employees. According to the chief of fiscal operations, he allocated the costs because it would not have been cost-effective to make all of the adjustments to the accounting records to reflect the correct costs for each program.

To determine the extent of improper charges to the LIHEAP, we also reviewed employees' time sheets for the period October 1995 through June 1996. The time sheets showed two employees charged time (totaling 1,050 hours) to the LIHEAP when their time sheets indicated they worked on the CSBG program or both the LIHEAP and CSBG program. In addition, for the same time period three employees charged time (totaling 3,071 hours) to the LIHEAP when their time sheets indicated they worked on a project to determine eligibility for a state energy assistance program that is administered by local energy utility companies. Because the department's employees charged their time to the LIHEAP, the department is using federal funds to pay for some of the costs to determine eligibility for state energy assistance programs. When we brought the incorrect time charges to the attention of the chief of fiscal operations, he credited the LIHEAP for the costs related to the 1,050 hours (totaling approximately \$14,800) and correctly charged the costs to the programs that benefited from the employees' time. In addition, the chief of fiscal operations credited the LIHEAP for the costs related to the 3,071 hours (totaling approximately \$58,700) and reassigned the costs to the state energy assistance program.

In our fiscal year 1994-95 audit, we similarly reported that the department had directed its employees to change their time sheets so that an estimated \$114,000 in employee time was charged to the Earthquake Disaster Assistance program even though the employees had not actually worked on that federal program. According to the department, it directed its employees to change their time sheets because the department had undercharged the Earthquake Disaster Assistance program in fiscal year 1993-94. In July 1995, when we discussed this issue with the department, it agreed to take steps to correct the errors that had been made by properly documenting the charges made to the Earthquake Disaster Assistance program. The department provided us with a schedule of the employees who had worked on the Earthquake Disaster Assistance program. The schedule summarized the program initially charged, hours worked, salary and benefits, and travel costs. However, the department

documented only \$65,000 of the \$114,000, and the schedule that was provided to us was incomplete and inaccurate.

In response to our fiscal year 1994-95 audit, the department stated that after it had identified all of the program costs and draws of federal funds, it would make any correcting entries to its accounting records. However, for fiscal year 1995-96, the department has changed its position. The department has not identified adequate support for all of the costs it charged to the federal Earthquake Disaster Assistance program in fiscal 1994-95, nor has it corrected its accounting records to adjust for the unsupported administrative costs. According to the chief of fiscal operations, it would not be cost-effective to identify the entries and correct the accounting records because the amount is immaterial.

In summary, federal guidelines for determining allowable costs under federal grants require that costs charged to federal programs be necessary, reasonable, and adequately documented. Throughout fiscal year 1995-96, the department's employees continued to improperly charge their time to federal programs when they had not actually worked on the programs. In addition, the department's attempt to correct improper charges of the department's administrative costs to the LIHEAP (totaling approximately \$110,960) resulted in charges to federal and nonfederal programs in proportions that did not represent their fair share, when the costs should have been directly charged to the federal programs that benefited from the services of the employees. Finally, the department has not provided complete and accurate support for nor made corrections to its accounting records to adjust for unsupported charges (totaling approximately \$114,000) to the Earthquake Disaster Assistance program that we identified in our fiscal year 1994-95 audit. Until the department takes the necessary steps to correct the above conditions, it cannot comply with federal guidelines.

Office of Criminal Justice Planning

The Office of Criminal Justice Planning (OCJP) incorrectly allocated the personal service costs for three employees working on the Drug Control and System Improvement—Formula Grant (DCSI). Specifically, personal service costs for two of the three employees were charged as indirect costs and allocated to all programs administered by the OCJP; however, the employees worked directly on the DCSI grant. The remaining employee's personal service costs were not allocated to the DCSI grant for March 1996 although the employee worked on the grant for half the month. As a result of the incorrect allocation, personal service costs charged to the DCSI grant were understated by at least \$63,000. Consequently, personal service costs allocated to the OCJP's other federal and state programs were overstated by the same amount. The OCJP uses budget estimates by branch to allocate personal service costs; however, they do not always update the labor distribution table when employees change branch assignments.

In addition, in fiscal year 1994-95, we reported that the OCJP inappropriately charged the DCSI grant more than \$50,000 in personal service costs for three employees in fiscal year 1994-95 and more than \$11,000 for one of the three employees during fiscal year 1993-94. The errors occurred because the accounting office did not update the labor distribution table when the OCJP employees changed assignments. In our fiscal year 1994-95 management letter, we recommended the OCJP ensure employment changes be properly reflected in the accounting system's labor distribution tables for accurate payroll cost allocation. In addition to

continuing to misallocate personal service costs, the OCJP has not corrected amounts identified in fiscal year 1994-95.

Recommendations

The Department of Community Services and Development should develop and implement the procedures necessary to ensure federal programs are charged only their fair share of the department's administrative costs. The procedures should include those steps necessary to ensure that costs charged to federal programs are necessary, reasonable, and adequately documented.

The OCJP should correct all personal service costs identified as incorrectly allocated. Additionally, it should implement a review process to ensure that personal service costs are allocated to the appropriate federal or state programs.

Views of Departments

Department of Community Services and Development:

Although the department does not disagree with our findings, the department's response does not address all of the issues we present in our findings, nor does it fully address our recommendations. In its response, the department stated it has corrected the specific problem we identified in our prior year's audit: the practice of employees to inappropriately change their time sheets to charge their time to programs when they had not actually worked on the programs. However, according to the department, the problem, as noted in the fiscal year 1994-95 audit, carried over to the 1995-96 fiscal year.

On the issues of continuing errors on time sheets that we found in fiscal year 1995-96 and the department's failure to correct for these errors, the department had the following comments. The fiscal year 1995-96 audit found that when the department made adjustments to its accounting records for incorrect time charges, it used an accounting code that charged some of the costs for employees' time to programs other than those on which the employees worked. However, the amount charged to the nonfederal program is insignificant and would cost more to correct than any value received. Additionally, the department's managers are reviewing time sheets much more closely. No changes are being made, except for legitimate errors.

Office of Criminal Justice Planning:

The OCJP does not dispute the audit finding. According to its executive director, when an employee transfers to a new branch, the personnel branch sends an employee status form to the accounting branch. However, as a result of a clerical error, this step was missed. The executive director stated the accounting branch will now review announcements of staff movement to ensure that all employee status forms are received.

Specific Federal Program Details

Department of Health and Human Services

Federal Catalog Number:	93.568
Federal Program Title:	Low-Income Home Energy Assistance Program
Federal Award Number and Period:	5G992201; FFY 1994-1995
State Administering Department:	Department of Community Services and Development

Department of Justice

Federal Catalog Number:	16.579
Federal Program Title:	Drug Control and System Improvement— Formula Grant
Federal Award Number and Period:	Various
State Administering Department:	Office of Criminal Justice Planning

Federal Financial Reporting

Reference Number: 96-9-1-Various

Federal Catalog Number:

Federal Program Title: See listing of specific federal program details following the discussion of the issues below.

Federal Award Number and Period:

State Administering Department:

Criteria

In our review of federal programs, we determined that the following were among the compliance requirements related to financial reporting:

The Code of Federal Regulations, Title 7, sections 3016.20(b)(1) and (2), Title 34, sections 74.21(a) and (b)(1) and (2), and Title 45, sections 92.20(a)(1) and (2) and (b)(1) and (2), requires the State to maintain accurate accounting records to properly track and report the financial activities related to federal grants. The State Administrative Manual, Section 20014, requires agencies receiving federal funds to reconcile federal financial reports with the official accounting records.

Condition

The State does not always ensure that its federal financial reports are accurate and reconcile to the accounting records. Failure to reconcile reports with the accounting records can result in misstated amounts in federal reports that are not supported by the accounting records. More specifically, we found the following:

- During fiscal year 1995-96, the Department of Social Services (social services) did not reconcile all of its quarterly federal cash transaction reports for June 30, 1996, or its final federal financial status reports to accounting records. As a result, we could not determine if receipts, disbursements, and cash balances, as reported on the federal cash transactions report for June 30, 1996, and total grant expenditures, as reported on financial status reports, agreed with the accounting records.
- The Department of Health Services (health services) did not reconcile its quarterly report of federal cash transactions for June 30, 1996, with its official accounting records. Specifically, health services reported disbursements totaling approximately \$4 million more for the Childhood Immunization Grant and \$23 million more for the Refugee and Entrant Assistance—State Administered Programs than it recorded in its accounting records.

Conversely, health services reported approximately \$18 million less in disbursements than it recorded in its accounting records for the HIV Care Formula Grant. As a result, health services overstated disbursements on the federal cash transactions report by approximately \$9 million.

- Health services also did not reconcile two of the final federal financial status reports submitted during fiscal year 1995-96. More specifically, for the period ending September 30, 1994, health services reported approximately \$3 million more in expenditures on the final financial status report for the Refugee and Entrant Assistance—State Administered Program than it recorded in the accounting records. In addition, for the period ending December 31, 1994, health services reported approximately \$187,000 more in expenditures than it recorded in its accounting records for the Childhood Immunization Grant.
- The Department of Aging's federal cash transaction report for the quarter ending June 30, 1996 did not agree with its accounting records. Specifically, it overstated disbursements for the Special Programs for the Aging—Title III, Part C-Nutrition Services Grant by approximately \$137,000 and also understated cash on hand by an equal amount.
- The California Community Colleges, Chancellor's Office (Chancellor's Office) did not reconcile its accounting records with the final federal financial status report for the Vocational Education Program during fiscal year 1995-96. Specifically, the Chancellor's Office reported approximately \$104,000 less in expenditures on the federal financial status report for the fiscal year 1994-95 allocation of vocational education funds than it recorded in its own records. The Chancellor's Office submits federal financial status reports to the California Department of Education, which then combines this information with its own data for submission to the federal government.

Recommendation

To ensure compliance with federal reporting requirements, the State should ensure that its departments prepare accurate federal financial reports and reconcile them to accounting records.

View of Departments

Social services agreed with the finding. Social services has been making continuous progress to improve its procedures. It has already automated and standardized grant ledgers used to reconcile data to the quarterly federal Payment Management System reports and to a variety of smaller federal grants. In addition, social services is developing a workplan to reconcile large entitlement programs. The use of multiple-platform accounting systems and the number and diversity of federal grants and disbursements have contributed to a complex reconciliation process; however, based on the current workplan, social services anticipates having procedures developed to implement new procedures for report reconciliations by July 1, 1997.

The acting chief of the Financial Management Branch of health services agreed that the information presented in the quarterly report of federal cash transactions should reconcile with

its accounting records. Therefore, health services is currently implementing procedures to perform these reconciliations.

Furthermore, the acting chief indicated that an error on the final financial status report for the Childhood Immunization Grant occurred because health services inadvertently included encumbrances in the total expenditures. Health services plans to prepare a revised report.

Finally, the acting chief agreed that the final financial status report for the Refugee and Entrant Assistance—State Administered Program did not reconcile with the accounting records. However, health services will reconcile subsequent years' reports with its accounting records and will document any differences for our review.

The chief of the Fiscal Operations Branch for the Department of Aging concurred with the audit finding and indicated that the Department of Aging has reviewed the report and made the necessary corrections.

The dean of Operations and Program Accountability at the Chancellor's Office explained that the discrepancy between the federal financial report and the accounting records occurred because the Chancellor's Office prepared the federal reports before all expenditure information was available. In the future, the Chancellor's Office will ensure that all expenditures are included in the federal financial status report.

U.S. Department of Agriculture

Federal Catalog Number:	10.551
Federal Program Title:	Food Stamps
Federal Award Number and Period:	7F6156; FY 1995-96
State Administering Department:	Department of Social Services

Federal Catalog Number	: 10.561
Federal Program Title:	State Administrative Matching Grants for Food Stamp Program
Federal Award Number and Period:	7F6156; FY 1995-96
State Administering Department:	Department of Social Services

U.S. Department of Education

Federal Catalog Number: 84.048

Federal Program Title: Vocational Educational—Basic Grants to the State

Federal Award Number and Period: V048A40005; FY 1994-95

State Administering Department: California Community Colleges, Chancellor's Office

U. S. Department of Health and Human Services

Federal Catalog Number: 93.560

Federal Program Title: Family Support Payments to States—Assistance Payments

Federal Award Number and Period: G-9604CA4007; FY 1995-96

State Administering Department: Department of Social Services

Federal Catalog Number: 93.561

Federal Program Title: Job Opportunities and Basic Skills Training

Federal Award Number and Period: G-9603CAJOBS; FY 1995-96

State Administering Department: Department of Social Services

Federal Catalog Number: 93.563

Federal Program Title: Child Support Enforcement

Federal Award Number and Period: G-9604CA4004; FY 1995-96

State Administering Department: Department of Social Services

Federal Catalog Number: 93.566
Federal Program Title: Refugee and Entrant Assistance—State Administered Programs
Federal Award Number and Period: G-96AACA9110; FY 1995-96
State Administering Department: Department of Social Services
Department of Health Services

Federal Catalog Number: 93.574
Federal Program Title: Child Care for Families at Risk of Welfare Dependency
Federal Award Number and Period: G-9604CA4012; FY 1995-96
State Administering Department: Department of Social Services

Federal Catalog Number: 93.645
Federal Program Title: Child Welfare Services—State Grants
Federal Award Number and Period: 1-9601CA1400; FY 1995-96
State Administering Department: Department of Social Services

Federal Catalog Number: 93.658
Federal Program Title: Foster Care—Title IV-E
Federal Award Number and Period: G-9601CA1401; FY 1995-96
State Administering Department: Department of Social Services

Federal Catalog Number: 93.659
Federal Program Title: Adoption Assistance
Federal Award Number and Period: 9601CA1401,9601CA1404/7; FY 1995-96

State Administering Department: Department of Social Services
Federal Catalog Number: 93.667
Federal Program Title: Social Services Block Grant
Federal Award Number and Period: 9601CASOSR; FY 1995-96
State Administering Department: Department of Social Services

Federal Catalog Number: 93.268
Federal Program Title: Childhood Immunization Grants
Federal Award Number and Period: H23/CCH904423-07; FY 1993-94
OCCH904423; FY 1995-96
State Administering Department: Department of Health Services

Federal Catalog Number: 93.917
Federal Program Title: HIV Care Formula Grants
Federal Award Number and Period: BRX/070041-95-0; FY 1995-96
State Administering Department: Department of Health Services

Federal Catalog Number: 93.045
Federal Program Title: Special Programs for the Aging—Title III,
Part C-Nutrition Services
Federal Award Number and Period: 95AACA1712; FY 1994-95
State Administering Department: Department of Aging

Identifying Grant Expenditures

Reference Number: 96-9-2-All Grants

Category of Finding: Reporting Requirements

Criteria

In our review of federal reports, we determined that the following were among the state and federal compliance requirements:

The Office of Management and Budget, Circular A-128, requires that the State prepare a schedule of federal assistance showing total expenditures for each federal program. Further, Circular A-128 requires that the State identify and audit all federal grants from which it expends more than \$20 million in a single year.

The California Government Code, Section 13300, assigns the Department of Finance the responsibility for maintaining a complete accounting system to ensure that all revenues, expenditures, receipts, disbursements, resources, obligations, and property of the State are properly tracked and reported. Further, the California Government Code, Section 16360, requires that all federal money received by the State be deposited in the Federal Trust Fund.

Condition

The State has not complied with a provision of the Office of Management and Budget (OMB), Circular A-128 (Circular A-128), requiring the preparation of a schedule showing total expenditures for each federal assistance program. The State has not complied because of limitations in its automated accounting systems. As a result, the schedule of federal assistance (beginning on page 173) shows total receipts, rather than expenditures, by program. Expenditure information is necessary to identify which grants the State is required to audit; OMB Circular A-128 requires the State to audit all grants, called major programs, for which it expends \$20 million or more. To ensure that we identified all major grants for audit, we reviewed accrual basis expenditure data, which are discretely identified in nonautomated records, for all programs with cash receipts within 10 percent of \$20 million to ensure that these programs should not have been classified as major programs. We identified one program with cash receipts that were within 10 percent of the major program threshold; however, our review of its expenditures verified that it did not exceed the \$20 million major program threshold.

The State also lacks complete, centralized records of the receipt of federal moneys, again contributing to difficulties in satisfying these federal requirements for reporting financial information. In 1978, the State took steps to establish a centralized record of federal receipts by creating the Federal Trust Fund for the deposit of all federal moneys administered through any state agency. This fund was created to provide better accountability for the State's receipts and expenditures of federal moneys. If the State consistently required that all federal

receipts be recorded in the Federal Trust Fund, the centralized records would help satisfy requirements under OMB Circular A-128; however, the State has instead allowed some federal receipts to be recorded in other funds. For example, during fiscal year 1994-95, the Department of Corrections (Corrections) received a \$33 million award of federal funds under the State Criminal Alien Assistance Program (SCAAP). These funds were deposited in the State's General Fund. Corrections also received a SCAAP award during fiscal year 1995-96 in the amount of \$31 million, which was also deposited in the State's General Fund. The Department of Finance (DOF) and the State Controller's Office (SCO) advised Corrections to deposit these funds in the General Fund.

Recommendations

As priorities and resources permit, the DOF should modify the State's accounting system to discretely identify expenditures for all federal programs. In addition, the DOF and SCO should ensure that state agencies deposit all federal moneys in the Federal Trust Fund.

View of Department

We have previously reported on the inadequacies of the State's financial reporting. The DOF has responded that the State's accounting system will require substantial modification to meet all federal and state requirements, and changes will be addressed in relation to other priorities and costs.

Corrections acknowledges that the federal moneys awarded under the SCAAP should have been deposited in the Federal Trust Fund and, beginning with fiscal year 1996-97, it has deposited SCAAP awards in the Federal Trust Fund.

Monitoring of Subrecipients

For many federal programs, the State acts as a pass-through entity to provide federal funds to various subrecipients. These subrecipients include cities, counties, special districts, school and community college districts, and nonprofit entities. In this capacity, the State is required to ensure that subrecipients of more than \$25,000 in federal assistance have an annual audit. If necessary, the State must also take steps to ensure that subrecipients correct any lack of compliance with federal laws and regulations identified during the annual audit. The State Controller's Office monitors the annual audit reports of cities, counties, special districts, and school districts. The California Community Colleges Chancellor's Office monitors the annual audit reports of the community college districts. The state agencies that provide the nonprofit subrecipients' federal assistance monitor those annual audit reports. We have identified issues related to the monitoring of the annual audit reports in each of these areas.

Monitoring of Nonprofit Subrecipients

Reference Number:	96-10-1-Various
Federal Catalog Number:	
Federal Program Title:	See listing of the specific federal program details following the discussion of the issues below.
Federal Award Number and Period:	
State Administering Departments:	

Criteria

In our review of federal programs, we found that the following were among the compliance requirements related to subrecipient monitoring:

The federal Office of Management and Budget (OMB), Circular A-133, requires nonprofit subrecipients of federal assistance totaling more than \$25,000 during a fiscal year to submit copies of the audit reports to the State within 30 days after the audit is completed and no later than 13 months after the end of the fiscal year audited. Also, for instances when subrecipients have failed to comply with federal laws and regulations, OMB Circular A-133 requires the State to make a management decision regarding audit resolution within six months of receipt of the audit report. Corrective action should then proceed as rapidly as possible.

Condition

The State did not always sufficiently monitor the audit reports of nonprofit subrecipients, nor did the State always take steps to ensure that audit findings were resolved within six months of receipt of the audit report. More specifically, we found the following conditions:

- The Office of Emergency Services did not have a system to identify the nonprofit subrecipients receiving more than \$25,000 in federal Disaster Assistance Program funds that should have submitted an annual audit report during fiscal year 1995-96.
- The Department of Health Services did not receive the audit reports from at least 14 of its nonprofit subrecipients receiving federal funds for the HIV Care Formula Grants that should have submitted audit reports during fiscal year 1995-96.
- The Department of Community Services and Development (department) did not always ensure that it had resolved reported audit findings associated with its nonprofit subrecipients within the six-month deadline. We reviewed four audit reports nonprofit subrecipients submitted to the department that contained audit findings related to the Low-Income Home Energy Assistance and the Community Services Block Grant programs. We found that the department had resolved audit issues related to only one of the four nonprofit subrecipients within six months after the department had received the audit report.

Without a system to identify the subrecipients who must submit specific audit reports to the appropriate state agency and ensure prompt resolution of audit findings, the State cannot ensure that all nonprofit subrecipients have submitted audit reports and that the nonprofit subrecipients are complying with federal laws and regulations.

Recommendation

The State should identify all nonprofit subrecipients required to submit an audit report prepared by an independent auditor. Further, the State should ensure audits are submitted on time and all reported audit findings are appropriately resolved within six months.

Views of Department

Agency officials agreed with the findings reported above and offered the following reasons for the reported conditions and planned resolution actions.

A fiscal unit program manager with the Office of Emergency Services said limited staffing had prevented the office from implementing a system to track single audits of nonprofit subrecipients. The Disaster Assistance Division currently has only one associate management auditor assigned. Two additional positions have been established to assist with this workload.

The chief of the CARE Section of the Office of AIDS at the Department of Health Services indicated that, effective April 15, 1997, all nonprofit HIV Care Formula Grants subrecipients must submit their required OMB Circular A-133 audit reports to the Audits and Investigation Unit of the department. Nonprofit subrecipients will also be reminded of the specific grant language requiring the audit and of their responsibility to comply.

The manager of the Audit Services Unit (ASU) within the Department of Community Services and Development (department) stated during fiscal year 1995-96 the department implemented budget reductions that reduced staffing levels of various units within the department. The staff of the ASU, the unit responsible for reviewing the audit reports submitted by the nonprofit

subrecipients, was reduced from four to two auditors. Additionally, one of the two remaining auditors was absent during six months of the year, and the remaining auditor was also performing reviews of agencies not funded by the department under a contractual agreement. However, the manager indicated that, subsequent to fiscal year 1995-96, the ASU filled one of the vacant positions with a full-time auditor.

Department of Health and Human Services

Federal Catalog Number: 93.917
Federal Program Title: HIV Care Formula Grants
Federal Award Number and Period: BRX 070041-94-0; FY 1994-95
State Administering Department: Department of Health Services

Federal Catalog Number: 93.568
Federal Program Title: Low-Income Home Energy Assistance
Federal Award Number and Period: 5G992201; FY 1994-95
State Administering Department: Department of Community Services and Development

Federal Catalog Number: 93.569
Federal Program Title: Community Services Block Grant
Federal Award Number and Period: 5G994002; FY 1994-95
State Administering Department: Department of Community Services and Development

Federal Emergency Management Agency

Federal Catalog Number: 83.516
Federal Program Title: Disaster Assistance
Federal Award Number and Period: N/A
State Administering Department: Office of Emergency Services

Monitoring of Community College Districts

Reference Number:	96-10-2-84.048
Federal Catalog Number:	84.048
Federal Program Title:	Vocational Education—Basic Grants to States
Federal Award Number and Period:	V048A40005; FFY 1994-95
State Administering Department:	California Community Colleges, Chancellor's Office

Criteria

In our review of federal programs, we determined that the following were among the compliance requirements related to the monitoring of subrecipients:

The federal Office of Management and Budget (OMB), Circular A-128, Sections 4(b) and 13(f), requires college districts receiving more than \$25,000 in federal assistance to have an annual audit completed within 12 months of the fiscal year-end. Also, in instances when college districts have failed to comply with federal laws and regulations, OMB Circular A-128, Section 9(c), requires the Chancellor's Office to ensure that community college districts take appropriate corrective action within six months of receipt of the audit reports.

Condition

The Chancellor's Office did not sufficiently monitor the fiscal year 1995-96 audit reports of the State's 71 community college districts, even though the office received and reviewed all these reports. Our review of audit reports of five community college districts disclosed that the Chancellor's Office had not ensured that the community college districts resolved the issues noted in these audit reports within six months of receiving the reports. These five reports identified insufficient internal controls, such as lack of procedures to monitor accounts receivable and failure to stamp invoices as paid; failure to comply with state requirements, such as insufficient or inaccurate attendance accounting and miscalculations in the Gann Limit; and failure to comply with federal regulations, such as incorrect calculations of Pell Grant awards and lack of satisfactory progress toward monitoring financial aid eligibility. Because the Chancellor's Office does not have a system to identify and ensure prompt resolution of all audit issues, it cannot be sure that community college districts are resolving failures to comply with regulations specific to the vocational education program. Additionally, without prompt resolution of audit issues, the Chancellor's Office cannot ensure that it will be able to recover any questioned costs or take corrective actions quickly.

Recommendation

The Chancellor's Office should implement a system to ensure that when failure to comply with federal regulations is identified in community college district audits, appropriate corrective action is taken quickly.

View of Department

The fiscal and business services administrator of the Chancellor's Office stated that for its review of audit reports received in fiscal year 1996-97, the Chancellor's Office implemented a process to summarize and forward audit issues involving federal programs identified in the audit reports to the appropriate program unit for resolution.

Monitoring of City, County, and Special District Subrecipients

Reference Number: 96-10-3-Various

Federal Catalog Number:

Federal Program Title: See listing of the specific federal program details following the discussion of the issues below.

Federal Award Number and Period:

State Administering Department:

Criteria

In our review of federal programs, we determined that the following were among the compliance requirements related to the monitoring of subrecipients:

The federal Office of Management and Budget (OMB), Circular A-128, Sections 4(b) and 13(f), requires local governments receiving more than \$25,000 in federal assistance to have an annual audit completed within 12 months of the fiscal year-end. Also, for instances when these audit reports indicate local governments have failed to comply with federal laws and regulations, OMB Circular A-128, Section 9(c), requires the State to ensure local governments comply within six months of receipt of the audit report.

Condition

The State does not always take steps to ensure that audit findings are resolved within six months of receipt of audit reports. The State Controller's Office (SCO) is responsible for monitoring the annual audit reports of the cities, counties, and special districts that receive federal assistance through the State. As part of this responsibility, the SCO identifies audit findings included in the audit reports and, depending on the nature of the finding, either takes steps to ensure that the local government resolves the issue or notifies the appropriate state agency. Once notified by the SCO, the state agency must ensure resolution.

During our review of the audit reports from five local governments that contained audit findings, we found that the SCO did not complete its review, nor did it inform the appropriate three state agencies of noncompliance contained in two of the audit reports until approximately six months after it received the reports. As a result, these state agencies were unable to meet the deadline that requires the State to ensure resolution of the federal issues within six months of receiving the audit reports. These two audit reports contained instances of a failure to comply with regulations that related to six federal programs.

Because the SCO did not quickly notify other state agencies, the agencies cannot ensure that the local governments will comply promptly with federal regulations noted in the audit reports, nor can it ensure that it will recover any questioned costs or take corrective actions quickly.

Recommendation

The SCO should complete its review of the audit reports from local governments in time to notify the appropriate state agencies to take action on issues identified in the audit reports within six months.

View of Department

The SCO agrees with the importance of the timely review of audit reports but questions the practicality of the present requirement. It has the following specific comments on this issue.

In accordance with the State Administrative Manual, the SCO provides the State of California centralized administration designed to ensure subrecipient units of local government comply with the Single Audit Act (SAA). Centralization of the single audit oversight function ensures consistency in terms of report review and the tracking of audit resolution by other state agencies.

The SAA requires state or local governments ensure that appropriate corrective action occurs within six months after the receipt of the audit report in instances of noncompliance with federal laws and regulations. The SAA does not address the situation where a state has centralized administration for report collection, review, and distribution. According to an assistant director of the U.S. General Accounting Office, there is no written guidance in regard to when the audit resolution period begins when the report is received by a central clearinghouse. The Bureau of State Audits is interpreting the six-month requirement as applying to the State as a whole. The SCO questions the feasibility of imposing the six-month requirement under the existing process when the audit reports are first reviewed and processed through a central clearinghouse.

The SCO agrees that single audit reports should be reviewed in a more timely manner to allow other state agencies the time to resolve instances of noncompliance. The SCO is developing a plan to emphasize a complete review earlier in the process so that SCO and the other state agencies can have a larger portion of the six month period to resolve audit findings.

Department of Housing and Urban Development

Federal Catalog Number:	14.228
Federal Program Title:	Community Development Block Grants—State Program
Federal Award Number and Period:	B-91-DC-06-0001; FY 1991 B-92-DC-06-0001; FY 1992
State Administering Department:	Department of Housing and Community Development

Department of Agriculture

Federal Catalog Number: 10.561
Federal Program Title: Food Stamp Program
Federal Award Number and Period: 7S2512; FY 1995
State Administering Department: Department of Social Services

Department of Health and Human Services

Federal Catalog Number: 93.959
Federal Program Title: Substance Abuse Prevention and Treatment Block Grant
Federal Award Number and Period: 94 B1 CA SAPT-04; FY 1994
State Administering Department: Alcohol and Drug Programs
Federal Catalog Number: 93.560
Federal Program Title: Aid to Families with Dependent Children Program
Federal Award Number and Period: G9504CA4007; FY 1995
State Administering Department: Department of Social Services
Federal Catalog Number: 93.563
Federal Program Title: Child Support Enforcement Program
Federal Award Number and Period: G-95-04-CA-4004; FY 1995
State Administering Department: Department of Social Services
Federal Catalog Number: 93.658
Federal Program Title: Foster Care Program
Federal Award Number and Period: 9501CA1404; FY 1995
9501CA1401; FY 1995
State Administering Department: Department of Social Services